Duke University
Durham, North Carolina
27708-0004

Office of the Executive Vice Provost
for Finance and Administration

303 Allen Building
Box 90004
Telephone (919) 684-3501
Facsimile (919) 684-7619

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Memorandum

To: Peter Lange
George L. McLendon
Bruce Kuniholm

From: James S. Roberts

Re: Summary of Financial Planning Review for the Creation of the Sanford School of Public Policy

This memo updates the financial and operational planning framework for the creation of a freestanding Sanford School of Public Policy at Duke University. A steering committee[1] charged with reviewing and updating earlier reports and analyses pertaining to the creation of a school of public policy has worked through the summer to provide this update in anticipation that the new school will be launched July 1, 2009. The steering committee endorsed this document in September; it has been updated with more current figures as they have become available. I hope this summary will be useful to document our methods and assumptions for the various bodies that will deliberate the final decision to create the Sanford School of Public Policy.

Background

The Public Policy task force appointed by the Provost in the spring of 2005 concluded that existing and prospective resources could be identified to provide a solid financial foundation for a freestanding school of public policy that would operate with the same incentives and financial responsibilities as other schools at Duke. Operating with these incentives as a school, Public Policy could increases its resources, academic stature and social impact beyond what would be possible as a department in Arts and Sciences. The university's senior leadership endorsed this conclusion and approved further financial and operational planning to create a free standing school of public policy at Duke.

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[1] The steering committee consisted of Jim Roberts (Executive Vice Provost for Finance and Administration), Sally Deutsch (Dean for the Social Sciences in Arts and Sciences), Sandy Connolly (Senior Associate Dean for Finance and Administration in Arts and Sciences), Bob Thompson (Dean of Trinity College, through June 30, 2008), Bruce Kuniholm (Director of the Terry Sanford Institute for Public Policy and Chair of the Department of Public Policy Studies in Arts and Sciences), and Susan Roth (Vice Provost for Interdisciplinary Studies). Scott Franklin (Associate Director of Academic Budgets in the Provost's Office) and David Arrington (Associate Director of Finance and Administration in Public Policy) participated ex officio and were primarily responsible for maintaining the updated financial models, working closely with Sandy Connolly.

In October of 2005 the Provost's Office created several working groups to verify the task force's conclusions about financial viability and to develop a multi-year pro forma budget. The working groups established a basis for undergraduate tuition (and financial aid) sharing acceptable to both Arts and Sciences and Public Policy, clarified responsibility for graduate and professional degree programs and associated financial aid support, and developed principles for the management of major cross-school centers that better defined the structure of the potential new school. With these fundamental structural issues clarified, working groups on budget and on fundraising worked in tandem to develop a multi-year pro forma budget and financing plan. The results of this planning, which confirmed the financial feasibility of creating a freestanding school of public policy provided that specific development targets were met, were shared during the spring of 2006 with the University Priorities Committee, the Academic Council and the Board of Trustees. Each of these bodies provided conditional endorsement of the proposal to create the Sanford School of Public Policy subject to final approval once fundraising goals were met.

The pro forma financial plan disseminated in the spring of 2006 established a minimum incremental endowment target of $40M for the creation of the Sanford School, with an ideal target of $65M to enable the new school to realize fully its ambitions for faculty growth. As of February 2009 a total of $30.1M had been pledged towards the threshold goal, of which $18.1M has been paid. Based on ongoing discussions with several key prospects, Public Policy hopes to achieve the $40M pledge goal this academic year. With the minimum endowment pledge goal close to fulfillment, the Provost asked the Executive Vice Provost to reconvene representatives of Public Policy, Arts and Sciences and the Provost's Office to verify the financial feasibility of creating a viable, vibrant new school and to outline as specifically as possible a transition plan that would protect the interests of Arts and Sciences while enabling the creation of the new school.

<u>Summer 2008 Verification and Update</u>

The steering committee revisited each of the major topics considered in the 2006 financial planning effort, consulting with expert resources outside the committee as needed, bringing the budget base and future projections up to date and documenting the financial framework with details necessary to define the accounting framework for the new school. The financial planning exercise had two fundamental purposes, the first focused on structure and the second focused on dynamics:

- The ***status quo transfer model*** describes in detail the transfer of accounts and resources necessary to operate the new school during the first year of its existence. This exercise describes the financial *structure* of the new school. Our basic working assumption has been that sufficient ongoing resources must be transferred to the new school at its inception to enable it to carry forward all activities funded under the current management framework. In principle, this is a resource neutral process as it simply organizes existing expenditures into a new organizational framework – the new school – and simultaneously remaps the resources now supporting those expenditures.

- The ***Sanford School development model*** projects the financial capacity of the new school to increase the size of its faculty and programs through the development of incremental sources of revenue. This requires a focus on *dynamics*, taking the structure of the status quo transfer as a starting point. A key postulate of all the prior planning for the creation of a school of public policy has been that its potential to develop new resources and hence to strengthen its faculty and programmatic impact would be greater as a freestanding school than as a department within Arts and Sciences.

The overall outcome of these efforts is reaffirmation of the earlier conclusion that Duke has the opportunity to create a strong, academically exciting and financially viable Sanford School of Public Policy without compromising the strength and effectiveness of Arts and Sciences. If fundraising goals are achieved on the timetable now anticipated, it should be possible to launch the new school July 1, 2009.

Status Quo Transfer Model

Schools at Duke operate under the principles of management center budgeting; accordingly, they are managed through school-specific income and expense statements. They are credited with their direct revenue (tuition, endowment income, indirect cost recoveries, annual fund, etc.) and must cover both their direct expenses (salaries, financial aid, facilities and other operating costs) and their appropriate share of academic and administrative support costs that support all the schools of the university. All schools contribute to these support costs. In addition, schools receive a portion of the university's "unassigned income" as determined by the Provost.[2]

This summer we reviewed previous work on the financial structure of the new school, the starting point for developing the status quo transfer and for modeling the school's future growth. The Sanford School will have financial responsibility for the same basic functions as every other school at Duke through a mix of direct and allocated costs. Also like other schools at Duke, the Sanford School will be supported by a diverse set of resources including undergraduate, professional and graduate tuition; annual giving; income from endowments; indirect cost recoveries; miscellaneous program income; and support from the university's unassigned income. Further details are described below.

[2] The unassigned income consists of income not "earned" by any school that is recorded centrally but then allocated to individual schools for long-term support; it is derived from annual income from The Duke Endowment, income from unrestricted permanent and quasi-endowments, and investment income generated by the university's working capital.

The first step in reviewing the budget structure of the new school and in developing the status quo transfer was to analyze all the operating expenditures currently supporting Public Policy and to specify the accounting framework that would constitute the expense side of the school's unrestricted income/expense statement. Based on analysis of the FY 08/09 budget for Public Policy within Arts and Sciences, the unrestricted expenditures of the new school will total approximately $20.9M in FY 09/10 as summarized in Table 1 below.

Table 1
Sanford School Unrestricted Expense

	Base 09/10 Transfer ($M)
Faculty Compensation	3.9
Operations Including Staff	2.3
Duke Center for International Development (DCID)	1.8
Undergraduate Financial Aid	1.7
Masters Program Financial Aid Expense (MPP, PIDP)	2.0
PHD Financial Aid	1.0
Building Maintenance & Operations	1.0
Debt Service	0.5
Other	1.7
Status Quo Direct Expense	**15.9**
Allocated Costs - Attributed (including Trinity Services)	1.9
Allocated Costs - Shared	3.1
Total Status Quo Expense	**20.9**

Restricted funds will add approximately $10M to the school's total expenditures, bringing its overall scale to about $31M. The Sanford School will be larger than Divinity but smaller than Law and Nicholas, the next largest schools.

Key assumptions and agreements on responsibility for expenses are as follows:

- The Sanford School will be responsible for funding all faculty, staff and operating costs, including building debt service and M&O.

- The Sanford School will be responsible for a pro rata share of unrestricted undergraduate aid expenditures based on its proportion of undergraduate tuition revenue.

- The Sanford School will run its own student services operation for the Masters of Public Policy (MPP) and Program in International Development Policy (PIDP). PIDP may separately contract with the Graduate School for application services.

- The Sanford School will be fully responsible for all financial aid for MPP and PIDP students.

- The Sanford School will be responsible for funding PhD stipends, in partnership with the Graduate School, consistent with expectations for financial commitments from other schools of the university.

- The Sanford School will be responsible for absorbing the full cost of faculty positions currently supported by Faculty Enhancement Initiative (FEI) resources allocated to Arts and Sciences. Existing bridge-support and FEI commitments will be transferred to the new school.

- The Sanford School will be responsible for the cost of renewing faculty research accounts and for any future faculty start-up agreements. Arts and Sciences will fully fund existing agreements and commitments for positions for which it has financial responsibility.

- The Sanford School will be responsible for university allocated academic and administrative support costs as determined by the Provost's Office on the same basis as for other schools under the Provost. In addition, The Sanford School will contribute annually to Trinity College support costs for undergraduate students in proportion to its undergraduate tuition income.

- The Sanford School will be eligible for supplemental support for particular, mutually agreed expenditures both from Arts and Sciences/Trinity College (e.g. supplemental support for undergraduate certificate programs) and from the Provost's Office (e.g. Faculty Enhancement Initiative, Faculty Diversity Initiative, The Duke Endowment Strategic Faculty Initiative, Bass Professorships, undergraduate program support).

Constructing the revenue side of the revenue and expense statement was less straightforward. Currently Public Policy is funded through Arts and Sciences but revenue streams are not divided down to the departmental level; departments have expense budgets but not revenue budgets. Hence we had to construct a pro forma revenue budget that could account for how existing activities are funded (there is no one right answer to this question) *and* provide a rational, transparent structure for the future school consistent with agreements about how the school would be structured academically. We reviewed and largely affirmed working assumptions from the summer of 2005 and spring of 2006 about how the revenue of the school would be described.

The following key agreements reflected in the income statement that follows should be noted:

- Although the Sanford School will not admit undergraduates, the new school will be credited with undergraduate tuition revenue in recognition of its continuing role in undergraduate education and its historic ties to Arts and Sciences. Undergraduate tuition will provide the largest single component of the new school's unrestricted revenue. The base tuition credited to the Sanford School will be $8.85M with annual increases tied to the rate of growth in undergraduate tuition charges but otherwise fixed by five year agreement.[3] It is important to emphasize that under the five year agreement there will be no automatic increase in revenue to Sanford as a result of increases in enrollment. Any future changes to the amount of the tuition transfer (other than the annual adjustment to reflect tuition rate changes) will be based on collaborative planning to address Trinity College and Sanford School curricular needs, with the Provost serving as the final arbiter.

- There will be a Sanford School annual fund. Previous pro forma financial models assumed that a fixed percentage of the Trinity Annual Fund would be allocated to Public Policy. Based on subsequent discussions and agreements, the working assumption now is that instead of receiving a fixed percentage of the Trinity Annual Fund, the new school will be credited with income based on its actual fundraising success under the ground rules agreed to by the Provost, deans and senior development officers. Alumni will have the option of designating their annual fund gifts to Public Policy, and Public Policy will actively solicit MPP and PhD graduates. Public Policy may also solicit alumni who were undergraduate majors who have not been contributors to the annual fund.

- The Sanford School will be credited with all income derived from its professional degree programs. Currently, registration fee income from the MPP and PIDP programs is retained by the Graduate School and implicitly supports PhD programs in Arts and Sciences. In addition, Arts and Sciences historically retained a portion of the MPP tuition income based on a fixed enrollment formula. The status quo resource transfer ensures that the Graduate School and Arts and Sciences are held harmless from this reassignment of revenue flows.

[3] The tuition credit to Sanford was derived from analysis of average course units of instruction provided by Public Policy faculty in recent years. Based on this analysis, the undergraduate tuition credit was derived from 235.9 FTE equivalent enrollments.

- The Sanford School will receive the full indirect cost recovery on grants for which members of its faculty are the Principal Investigators and will be responsible for any associated university assessments.

- The plan anticipates the inclusion of Duke Center for International Development (DCID) as a unit within the Sanford School. The Dean may structure internal incentive arrangements with DCID, subject to approval by the Provost. The Provost's Office will relinquish its current share of DCID net income to support the Sanford School (estimated at $187K in FY09/10). Allocated costs associated with DCID activity are covered in the status quo resource transfer.

- Income from endowed chairs currently supporting Public Policy faculty members will transfer to the new school. Endowments restricted to public policy will remain with the Sanford School after current incumbents relinquish their chairs. Endowments related to university or school chairs not restricted to public policy will revert to the Provost or the Dean of the Faculty after current incumbents relinquish their chairs.

Based on these agreements, the status quo revenue structure and resource transfer from Arts and Sciences would be as indicated in Table 2 below.

Table 2
Sanford School Unrestricted Revenue

	Base 09/10 Transfer ($M)
Undergraduate Tuition	8.9
Masters Program Tuition & Fees	3.2
DCID Tuition & Fees	3.2
PHD Tuition	0.5
Indirect Cost Recoveries	0.8
Unrestricted Endowment Income	1.8
Other Program Income	0.3
Status Quo Direct Revenue	**18.5**
Base Unassigned Income	2.3
Total Status Quo Revenue	**20.9**

Note that status quo direct revenue transfer of $18.5M does not fully cover the status quo expense of the school summarized in Table 1. The difference is $2.3M and would be covered by an allocation of $2.3M of base unassigned income, bringing total revenue to $20.9M and the status quo budget model into balance. It is characteristic of all the schools that their direct revenue does not fully cover their total direct and allocated costs without unassigned income support.

The Sanford School Development Model

The status quo resource transfer, including base unassigned income, provides the Sanford School with the resources to support an activity level commensurate with its current role as a leading social sciences department within Arts and Sciences. This level of resources does not account for the investment in administrative infrastructure (e.g. development staffing) and faculty growth required to transform a department into a dynamic, free-standing school. Consistent with prior understandings, the Sanford School itself is responsible for generating the additional resources required to realize this vision. Some of these investments in infrastructure and faculty development have already been incurred *in anticipation* of school status; others are planned for the future. We have accounted for the expenses incurred in anticipation of becoming a school separately from the status quo transfer because in principle they should be funded with incremental resources generated by Sanford, as would any other subsequent investment in the school's infrastructure or programs. As one indicator of this investment trajectory, it is worth noting that the Arts and Sciences faculty FTE commitment to Public Policy stood at 25 prior to the discussion of school status; as of the fall of the 2008, the tenure-track faculty stands at 28.5 and the model projects additional growth to 31.5 by the fall of 2009 and the official launch of the Sanford School. The development model's future projections will be contingent on raising resources to fund additional faculty lines. Meanwhile, the Institute has made substantial progress towards the goal of a faculty of 40 articulated in 2006 planning documents. Reaching that target will require endowment in excess of the $40M threshold goal.

The faculty and infrastructure investments associated with becoming a school are not perfectly aligned with the flow of income from new endowment gifts. It will take several years for pledges to be paid and for endowment income to be released under the university's endowment payout policies. The mismatch between new expenditures and new revenues requires a bridging strategy involving two sources. Sanford will devote 50% of the Dean's Strategic fund, co-managed with the Provost, to supporting the transition costs of becoming a school – the balance will be available as a backstop resource and source of additional strategic investment funds. The Provost has also committed a $3.5M bridge funding "line of credit" to help the school manage the transition to a steady-state flow of endowment income. This combination of bridging resources balances the Sanford School development model.

FY 09/10 Pro Forma Financial Plan

The university's budget process is underway, and we are proceeding with development of a separate income and expense budget for the Sanford School of Public Policy. While detailed line item budgeting is not yet complete, the framework developed in this document has been verified. The several elements of the transition plan are brought together in Table 3, which shows revenues and expenses for both the status quo budget transfer and recent enhancements associated with the creation of the school. Revenues and expense total $22.5M. Sponsored projects and funding from restricted endowments will add additional funding. Further expansion of the school's faculty and infrastructure will depend on available resources, including completion of its fundraising campaign.

Table 3
FY 09/10 Sanford Pro Forma Plan

FY 09/10 Pro Forma for the Sanford School of Public Policy
Unrestricted Budget (excludes existing restricted and endowment activity)

($M)	Status Quo Transfers	Year 1 Enhancements	Total
Revenue			
Undergraduate Tuition	8.9	-	8.9
Masters Program Tuition & Fees	3.2	-	3.2
DCID Tuition & Fees	3.2	-	3.2
PHD Tuition Income	0.5	-	0.5
Indirect cost Recoveries	0.8	-	0.8
Endowment Income	1.8	0.8	2.7
Other Program Income	0.3	-	0.3
Annual Fund	-	0.2	0.2
Faculty Enhancement & Bridge Support	-	0.7	0.7
Direct Revenue	**18.6**	**1.7**	**20.2**
Base Unassigned Income	2.3	-	2.3
Total Revenue	**20.9**	**1.7**	**22.5**
Expense			
Faculty Compensation	3.9	0.9	4.8
Operations Including Staff	2.3	0.3	2.6
DCID Expenditures	1.8	-	1.8
Undergraduate Financial Aid	1.7	-	1.7
Masters Program Aid Expense (MPP, PIDP)	2.0	-	2.0
PHD Financial Aid	1.0	-	1.0
Building Maintenance & Operations	1.0	-	1.0
Debt Service	0.5	-	0.5
Other	1.6	0.5	2.1
Direct Expense	**15.9**	**1.7**	**17.6**
G&A *	5.0	-	5.0
Total Expense	**20.9**	**1.7**	**22.6**
Surplus / (Deficit)	**-**	**-**	**-**

* *G&A Includes Trinity & Graduate School Services*

Conclusion

The committee's review has affirmed the belief that a financially viable, academically dynamic freestanding school of public policy can be created at Duke University without compromising the interests of Arts and Sciences and with every prospect of enhancing the standing of the university as a whole, both at home and abroad. While the committee believes that unassigned income and bridge support will be sufficient to launch the new school, it will be critical that the Sanford School carefully manage expenditures in the early years to insure its long-term financial stability. If anticipated resources are delayed, Sanford may need to modulate its faculty growth plans until resources become available.

JSR:hc

xc: Sarah Deutsch
Sandy P. Connolly
Susan Roth
David Arrington
Amy B. Oates
Scott Franklin